

From: Abhay Padgaonkar
Date: March 1, 2021
Docket: APS Rate Review (E-01345A-19-0003); 2019 APS Rate Case (E-01345A-19-0236)
Re: **Don't Be Fooled by APS's "Loss" in 4Q 2020!**

Dear Commissioners:

Pinnacle West Capital Corp. (PNW), parent of APS, reported a net loss of \$19.4 million for the 4th quarter of 2020. The 'Income Before Income Taxes' was an even larger loss of \$34 million. The company described the "main drivers" for the loss as: 1) Settlement with the Arizona AG's Office and 2) The decision to pull forward near-term operations and maintenance (O&M) expense into the final quarter of 2020.¹

But don't be fooled by this reported "loss," driven by \$70 million in unusual, nonrecurring items, which together appear to have turned a **\$36 million Income Before Income Taxes into a \$34 million loss**: 1) Residential revenues for 2020 reflect a \$24 million reduction related to the Arizona AG matter² and 2) The company "pulled forward from future years" \$46 million of future O&M to "utilize above average weather benefit in 2020."³

"Pull Forward" of Future O&M

Was the "pull forward of future O&M" an actual expense in Q4 2020 or was it simply an accrual in advance? Was there a regulatory or business rationale or was it just an accounting gimmick to tamp down Net Income in 2020?

It is not clear. Pinnacle West reported 'Income Before Income Taxes' of \$648 million in 2020, which was **20%** higher than in 2019. Had it not been for the \$70 million one-time impact, the year-over-year increase would have skyrocketed by a jaw-dropping **32%**. Massive profit during the pandemic, and especially in the middle of a contentious and litigated Rate Case, would have certainly generated unwanted, highly negative publicity for APS.

The highly unusual "pull forward" language suggests that Pinnacle West *may have* accrued the \$46 million O&M expense in advance. If true, that may violate Generally Accepted Accounting Principles or GAAP: "The use of the accrue-in-advance method (where major maintenance costs are accrued ahead of the maintenance taking place) is prohibited in annual and interim financial statements."⁴ Pinnacle West CFO Ted Geisler made the following statements (emphasis added) to the investors on February 24, 2021⁵ that should raise eyebrows:

- *In response to the unusually large weather benefit, we did accelerate the timing of future O&M initiatives. While the pull forward increased our 2020 total O&M, **our originally budgeted O&M was trending down.***
- *The pull forward was **unique to 2020**, given extreme weather. We **want to take advantage of that and derisk future years.***
- *... it's not necessarily just 2021. It's pull forward of future O&M. And so **it's picking up things that would have gone in subsequent years as well.***

QUESTIONS: 1) Did the O&M "pull forward" use the accrue-in-advance method? 2) If it did, how is it GAAP-compliant? 3) If it is not GAAP-compliant, why didn't the company provide Non-GAAP Reconciliation like it did for the AG Settlement? 4) Even if it is GAAP-compliant or if the company did incur the \$46 million originally planned for future years in Q4 2020, what was the regulatory or business rationale for a seemingly unnecessary expense? 5) Why did the company not explain it in Plain English and instead used unusual "pull forward" language? 6) Was the company's motive behind the "pull forward" decision to report a loss rather than a profit?

¹ Pinnacle West News Release at: <http://www.pinnaclewest.com/newsroom/company-news/news-release-details/2021/Pinnacle-West-Reports-2020-Full-Year-and-Fourth-Quarter-Results/default.aspx>

² Pinnacle West 2020 Form 10-K at: http://s22.q4cdn.com/464697698/files/doc_financials/2020/q4/Final-PNW-2020.12.31-10-K.pdf#page=119

³ Pinnacle West 4th Quarter 2020 Presentation at: http://s22.q4cdn.com/464697698/files/doc_financials/2020/q4/4Q-2020-Earnings-Slides.pdf#page=13

⁴ PwC Utilities and Power Companies Guide at: <https://www.pwc.com/us/en/cfoirect/assets/pdf/accounting-guides/pwc-guide-utilities-power-companies.pdf#page=504>

⁵ "Pinnacle West Capital Corp. (PNW) Q4 2020 Earnings Call Transcript" at: <https://www.fool.com/earnings/call-transcripts/2021/02/24/pinnacle-west-capital-corp-pnw-q4-2020-earnings-ca/>